

CITY OF STEPHENVILLE INVESTMENT POLICY

I. POLICY STATEMENT

This document is to establish an investment policy that provides clear and concise guidelines for investing City of Stephenville funds; providing for security of capital, diversification and maximum return.

It is the policy of the City of Stephenville, Texas ("City") that the administration of its funds and the investment of those funds shall be handled as its highest public trust. Investments shall be made in a manner which will provide the maximum security of principal invested through limitations and diversification while meeting the daily cash flow needs of the City and conforming to all applicable state and City statutes governing the investment of public funds. The receipt of a market rate of return will be secondary to the requirements for safety and liquidity. It is the intent of the City to be in complete compliance with the City Charter, local law and the Texas Public Funds Investment Act. The earnings from investment will be used in a manner that best serves the public trust and interests of the City.

II. SCOPE

This investment policy applies to all the investment activities and financial assets of the Government of the City. All financial assets of all funds of the City at the present time and any funds to be created in the future will be administered in accordance with the provisions of these policies. All funds are accounted for in the City's Comprehensive Annual Financial Report (CAFR).

This policy serves to satisfy the statutory requirement to define and adopt a formal investment policy. The City commingles its funds into one pooled investment fund for investment purposes for efficiency and maximum investment opportunity. These funds are defined in the CAFR and include:

| | |
|-----------------------|---------------------------|
| General Fund | Storm Water Drainage Fund |
| Capital Projects Fund | Utilities Fund |
| Special Revenue Fund | Landfill Fund |
| Debt Service Fund | Airport Fund |

III. OBJECTIVES AND STRATEGY

It is the policy of the City that all funds shall be managed and invested with four primary objectives, listed below in order of their priority. These objectives encompass:

Safety and Security of Principal

The primary objective of the City's investment activity is the preservation of capital in its overall financial portfolio. Each investment transaction will seek first to ensure that capital losses are avoided, whether they are from securities defaults or erosion of market value. To obtain this goal, diversification is required in the portfolio's composition. The highest credit quality and marketable securities will be used to protect the City's assets. The suitability of each investment decision will be made on the basis of these objectives.

Liquidity

The City's investment portfolio will remain sufficiently liquid to enable it to meet all operating requirements that might be reasonably anticipated. Liquidity will be achieved by matching investment maturities with cash flow requirements.

Return on Investment (Yield)

The City's investment portfolio shall be designed with the objective of regularly exceeding the average rate of return on three-month US Treasury Bills. The investment program will seek to augment returns above this threshold consistent with the cash flow of the portfolio, risk limitations identified herein, and prudent investment principles.

Local Considerations

The City seeks to attain market rates of return on its investments, consistent with constraints imposed by its safety and security objectives, cash flow consideration, and state and local laws that restrict the placement of certain public funds.

Strategy

The primary objective for these funds will be liquidity and reasonable market yield. Funds will be invested in accordance with the City's Investment Policy. The authorized securities chosen or pool utilized for this portfolio will be of the highest credit quality and marketability supporting the City's objectives of safety and liquidity. Securities, when not matched to a specific liability, will be short term and of a liquid nature to provide adequate liquidity for the City. The portfolio shall be diversified to protect against market and credit risk in any one sector.

The weighted average maturity on the pooled investment group will be no greater than one year and is based on the City's cash flow analysis of needs. Because the funds are pooled for investment purposes, the portfolio will address the varying needs of all funds in the pooled fund group, recognizing liquidity needs as well as the desire to extend slightly for incremental return on core funds in the pool.

IV. LEGAL LIMITATIONS, RESPONSIBILITIES AND AUTHORITY

The City intends for all investment activities to comply with state and local laws. Direct specific investment parameters for the investment of public funds in Texas are found in the Public Funds

Investment Act, Chapter 2256, Texas Government Code, (the "Act"). The Act is attached as Exhibit A. The Public Funds Collateral Act, Chapter 2257, Texas Government Code, specifies collateral requirements for all public funds deposits. The Collateral Act is attached as Exhibit B.

The Interlocal Cooperation Act, Chapter 791, Texas Government Code, authorizes local governments in Texas to participate in an investment pool established thereunder. That statute and reference to authorized investment in investment pools in the Act, is primary authority for use of investment pools by political subdivisions of the State of Texas.

V. DELEGATION OF INVESTMENT AUTHORITY

The Financial Director, acting on behalf of the City Council, is designated as the Investment Officer of the City and is responsible for investment management decisions and activities. The Council is also responsible for considering the quality and capability of staff, investment advisors, and consultants involved in investment management and procedures. The Council may contract with a Registered Investment Advisor to assist the Investment Officer in the fulfillment of his responsibilities. All participants in the investment process shall seek to act responsibly as custodians of the public trust.

No officer or designee may engage in an investment transaction except as provided under the terms of this policy and the procedures established by the Investment officer and approved by the City Administrator.

VI. PRUDENCE

The standard of prudence to be used in the investment function shall be the "prudent person" standard and shall be applied in the context of managing the overall portfolio. The standard states:

“Investments shall be made with judgement and care, under circumstances then prevailing, which persons of prudence, discretion, and intelligence exercise in the management of their own affairs, not for speculation, but for investment, considering the probable safety of their capital as well as the expected income to be derived.”

Limitation of Personal Liability

The Investment Officer and those delegated investment authority under this policy, when acting in accordance with the written procedures and this policy and in accord with the Prudent Person Rule, shall be relieved of personal responsibility and liability in the management of the portfolio provided that deviations from expectations for a specific security's credit risk or market price change or portfolio shifts are reported in a timely manner and that appropriate action is taken to control adverse market effects.

VII. INTERNAL CONTROLS

The Investment Officer shall establish a system of written internal controls that will be reviewed annually with the independent auditor of the City. The controls shall be designed to prevent loss of

public funds due to fraud, employee error, misrepresentation by third parties, unanticipated market changes, or imprudent actions by employees of the City.

Cash Flow Forecasting

Cash flow forecasting is designed to protect and sustain cash flow requirements of the City. Supplemental to the financial and budgetary systems, the Investment Officer will maintain a cash flow forecasting process designed to monitor and forecast cash positions for investment purposes. Cash flow will include the historical researching and monitoring of specific cash flow items, payables and receivables as well as overall cash position and patterns.

Weighted Average Maturity

The portfolio will be structured so that the maximum weighted maturity of the overall portfolio based on the stated maturity dates will not exceed one year.

Audits

An annual audit for compliance of the portfolio to this policy will be completed by the external auditor along with a review of the quarterly reports provided to Council.

VIII. AUTHORIZED INVESTMENTS

Acceptable investments under this policy shall be limited to the instruments listed below. The investments are to be chosen in a manner that promotes diversity or market sector and maturity. The choice of high-grade government investments and high-grade money market instruments is designed to assure the marketability of those investments should liquidity needs arise.

- A. Obligations of the United States Government, its agencies and instrumentality's, and government sponsoring enterprises, excluding collateralized mortgage obligations (CMOs), not to exceed two year to stated maturity;
- B. Fully insured or collateralized certificates of deposit from a bank doing business, in the State of Texas and under the terms of a written depository agreement with that bank, not to exceed one year to the stated maturity;
- C. Repurchase agreement and reverse repurchase agreements as defined by the Public Funds Investment Act, not to exceed 180 days to stated maturity, collateralized with Section VIII.A. above, provided an executed PSA Master Repurchase Agreement is on file with the City and the counter party bank or primary dealer, or flexible repurchase agreement longer than 180 days if matched to expenditure plan of the bond funds; and
- D. Constant dollar Texas Local Government Investment Pools as defined by the Public Funds Investment Act.

If additional types of securities are approved for investment by public funds by state statute, they will not be eligible for investment by the City until this policy has been amended and the amended version approved by the City Council.

Competitive Bidding Requirement

All securities, including certificates of deposit, will be purchased or sold after three (3) offers/bids are taken to verify that the City is receiving fair market value/price for the investment.

Delivery versus Payment

All security transactions, including collateral for repurchase agreements, entered into by the City, shall be conducted on a delivery versus payment (DVP) basis.

IX. AUTHORIZED FINANCIAL DEALERS AND INSTITUTIONS

All investments made by the City will be made through either a regional or primary broker/dealer that complies with the City's requirements. The City, or its Investment Advisor, shall maintain a list of financial institutions that are authorized to provide investment services. The list of approved broker/dealers is attached as Exhibit D and part of this policy for Council approval purposes. At a minimum the City shall conduct an annual evaluation of each bank's creditworthiness to determine whether it should be on the "Qualified Institution" listing. Banks shall continuously provide their most recent "Consolidated Report of Condition" (call report).

Securities broker/dealers shall meet certain criteria as determined by the Investment Officer. A list of no more than five (5) authorized broker/dealers will be established and maintained. Those firms on the list must meet the following criteria:

- Provision of an audited financial statement for the most recent period,
- Proof of certification by the National Association of Securities Dealers (NASD),
- Proof of current registration with the State Securities Commission, and
- Completion of a City questionnaire.

Every dealer with whom the City transacts business will be provided a copy of this Investment Policy to assure that they are familiar with the goals and objectives of the investment program. The broker/dealer will be required to return a signed copy of the Certification Form substantially in the form provided as Exhibit C.

A list of the authorized broker/dealers will be provided to the Council annually for their review.

X. DIVERSIFICATION AND MATURITY LIMITATIONS

It is the policy of the City to diversify its investment portfolio. Invested funds shall be diversified to minimize risk or loss resulting from over-concentration of assets in a specific maturity, specific issuer, or specific class of securities. Diversification strategies shall be established and periodically reviewed. At a minimum, diversification standards by security type and issuer shall be:

| | |
|---|-------------------|
| U.S. Treasuries and securities with the US Government's guarantee | 100% |
| U.S. Government agencies and instrumentality's | not to exceed 80% |
| Fully insured or collateralized CDs | not to exceed 30% |
| Repurchase agreement | 100% |
| Local Government Investment Pools | |
| Liquidity Pools | 100% |
| Maximum percent ownership of pool | not to exceed 20% |

The portfolio shall be diversified by maturities. The Investment Officer, to the extent possible, will attempt to match investment with anticipated cash flow requirements. Matching maturities with cash flow dates will reduce the need to sell securities prior to maturity, thus reducing market risk. Unless matched to a specific requirement, the funds may not be invested more than 20% of the portfolio for a period greater than one (1) year.

XI. SAFEKEEPING AND COLLATERALIZATION

All securities shall be brought on a delivery versus payment basis and be held in safekeeping by either the City, an independent third party financial institution, or the City's designated depository. All safekeeping arrangements shall be designated by the Investment Officer and an agreement of the terms executed in writing. The third party custodian shall be required to issue safekeeping receipts to the City listing each specific security, rate, description, maturity, CUSIP number, and other pertinent information. Each safekeeping receipt will be clearly marked that the security is held for the City or pledged to the City.

All securities pledged to the City for certificates of deposit or demand deposits shall be held by an independent third party bank domiciled in Texas. The safekeeping bank may not be within the same holding company as the bank from which the securities are pledged.

Collateralization

Collateralization shall be required on two types of investments:

- a. Certificates of deposits over the FDIC insurance coverage of \$100,000, and
- b. Repurchase agreements.

In order to anticipate market changes and provide a level of additional security for all funds, the collateralization level required will be 102% of the market value of the principal and accrued interest.

XII. PERFORMANCE EVALUATION AND REPORTING

The Investment Officer shall submit monthly reports to the City Administrator and quarterly and annual reports to the City Council containing sufficient information to permit an informed outside reader to evaluate the performance of the investment program. At a minimum, these summary management reports shall contain:

Beginning and ending market value of the portfolio by market sector and total portfolio,
 Beginning and ending book value of the portfolio by market sector and total portfolio,
 Transactions that change market and book value,
 Total accrued interest for the period,
 Overall current yield-to-maturity of the portfolio,
 Overall weighted average maturity of the portfolio,
 Maximum maturities, by security, in the portfolio,
 Total earnings for the month and fiscal year-to-date, and
 Performance comparison including average yield on 3-month US Treasury Bill.

The detail reports with full information on each individual position in the portfolio including:

| | | |
|--------------------------------|------------------------|----------------------------|
| Par amount | Yield-to-maturity | Book value (Beg and End) |
| Coupon or rate | Yield at cost | Market value (Beg and End) |
| Maturity date | CUSIP | Gain/loss |
| Total coupon interest received | Amortization/Accretion | Interest earning accrued |
| Transactions for the period | | |

The reports will be prepared jointly by all involved in the investment activity and be signed by all staff involved in accordance with the Act.

Market Price

An independent source will be used to obtain accurate market prices for all securities in the portfolio in order to assure accurate reporting.

XIII. DEPOSITORIES

The City will designate one banking institution through a competitive process as its central banking service provider at least every two years, according to Charter. This institution will be used for normal banking services including disbursements, deposits, lockbox, controlled disbursement and safekeeping of securities.

XIV. INVESTMENT POLICY ADOPTION BY CITY COUNCIL

The City's investment policy shall be adopted by the City Council. The City Administrator and City Council shall review the policy on an annual basis. After its annual review, the Council shall adopt a written resolution approving the Policy and recognizing any changes made to that Policy.

EXHIBITS A AND B

**PUBLIC FUNDS INVESTMENT ACT
(Texas Government Code Section 2256)**

**PUBLIC FUNDS COLLATERAL ACT
(Texas Government Code Section 2257)**

EXHIBIT C

**BROKER/DEALER CERTIFICATION FORM
as required by Texas Government Code 2256.005(k)**

CITY OF STEPHENVILLE, TEXAS

I, as a registered principal for the firm does hereby certify that I, and the broker covering this account, _____, have received and both have thoroughly reviewed the investment policy of the City.

The firm has implemented reasonable internal procedures and controls in an effort to preclude investment transactions between this firm and the City, which do not comply with this policy.

Name: _____

Title: _____

Date: _____

EXHIBIT D

**APPROVED BROKER/DEALERS
as required by Texas Government Code 2256.025**

CITY OF STEPHENVILLE, TEXAS

Broker/Dealers:

Mizuho
Citigroup
Merrill Lynch
Bank of America
Multi-Bank Securities, Inc.

Banks for purchase of Certificates of Deposits:

First Financial Bank

Local Government Investment Pool

TexPool (Public Funds Investment Pool)
TexSTAR

EXHIBIT E

AUTHORIZED REPRESENTATIVES

Authorized Representatives of the Client

| Name/Title | Phone | Fax | E-mail |
|---|--------------|--------------|--|
| Mark A. Kaiser, CPA City Administrator | 254-918-1225 | 254-918-1207 | mkaiser@ci.stephenville.tx.us |
| Walter G. Wood, CPA Director of Finance & Admin. | 254-918-1211 | 254-918-1207 | wwood@ci.stephenville.tx.us |
| Deanna Saucedo Accountant | 254-918-1229 | 254-918-1207 | dsaucedo@ci.stephenville.tx.us |
| Cindy Stafford City Secretary | 254-918-1212 | 254-918-1207 | cstafford@ci.stephenville.tx.us |